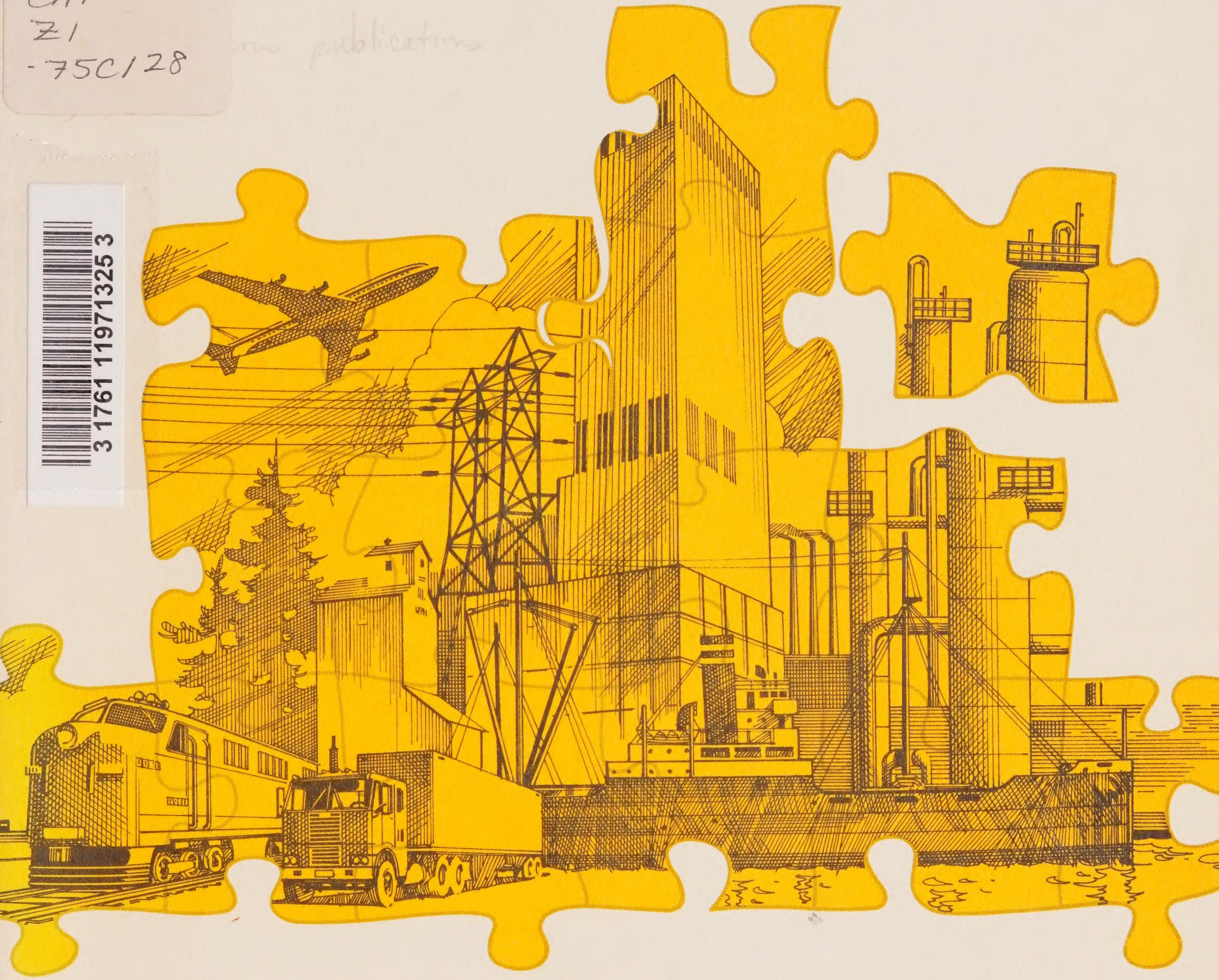
Royal Commission on Corporate Concentration



STUDY NO. 28

Corporate Concentration and the Canadian Tax System

A Background Report

Royal Commission on Corporate Concentration

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by

Stikeman, Elliott, Tamaki, Mercier and Robb

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FOREWORD

In April 1975, the Royal Commission on Corporate Concentration was appointed to "inquire into, report upon, and make recommendations concerning:

(a) the nature and role of major concentrations of corporate power in Canada;

(b) the economic and social implications for the public interest of such concentrations; and

(c) whether safeguards exist or may be required to protect the public interest in the presence of such concentrations."

To gather informed opinion, the Commission invited briefs from interested persons and organizations and held hearings across Canada beginning in November 1975. In addition, the Commission organized a number of research projects relevant to its inquiry.

One such project was directed at investigating ways in which the Canadian income tax system may encourage or discourage corporate concentration. A major part of that project involved this study of the relationship between concentration and the tax system by senior partners of the distinguished Montreal legal firm of Stikeman, Elliott, Tamaki, Mercier and Robb. The report covers selected provisions of the tax system including the small business deduction, tax concessions, investment tax credit, capital cost allowance, consolidation of returns, designated surplus, dividend stripping, rollover provisions, and capital gains taxation.

The Commission is publishing this and other background studies in the public interest. We emphasize, however, that the analyses presented and conclusions reached are those of the author, and do not necessarily reflect the views of the Commission or its staff.

Donald N. Thompson
Director of Research

TABLE OF CONTENTS

		Page
INTRODUCTION		1
PART ONE	- General Rules Concerning Corporate Tax Rates and the Computation of Income	2
PART TWO	- Corporations and their Shareholders, and the Distinction Between Public and Private Corporations	11
PART THREE	- Transfer of Assets, Share-For-Share Exchanges, Amalgamations, Liquidations and Other Corporate Reorganizations	27
PART FOUR	- The Taxation Of Individuals: Employees' Stock Ownership Plans and Venture Capital Corporations	33
CONCLUSION		39

INTRODUCTION

This report aims to summarize and comment on certain aspects of the Canadian income tax system which may have a bearing on a study of the broader issues relating to corporate concentration in Canada. In particular, we have been asked to summarize those provisions of the Income Tax Act which may have an impact on the matters before the Commission, and to make any relevant observations. Thus, the study does not seek to analyze the general impact of taxation on the Canadian economy.

The scope of this report extends to income tax on both corporations and individuals, referring always to tax levied under the Income Tax Act of Canada (referred to herein as "the Act" or ITA) unless specific reference is made to tax levied by one of the Canadian provinces.

As a general rule, the Act contains no provisions whose intent is to promote or hinder corporate concentration in Canada. There are, however, certain areas of the Act which may have some bearing on the matter, and we have described and commented upon some of these in the report.

Thus in Part One, we discuss certain general rules concerning corporate tax rates and the computation of income. In particular, we deal with the small business deduction, the reduced rate of tax for manufacturing and processing profits, the investment tax credit, the provisions governing goodwill, capital cost allowance and tax losses, and the absence of rules permitting the filing of consolidated returns.

In Part Two, we examine the interrelationship in the tax system between corporations and their shareholders, with particular emphasis on the distinction which is made between public and private corporations. We also consider the rules regarding designated surplus and dividend stripping.

In Part Three, we examine the so-called "rollover" provisions which permit deferral of the tax which might otherwise become payable, and the preservation of tax values and accounts which might otherwise be extinguished, on transactions such as transfers of assets, share-for-share exchanges, amalgamations and liquidations. We also consider the fiscal implications to both vendor and purchaser of the acquisition of a business by a sale of assets and assumption of liabilities, as opposed to a sale of shares.

In Part Four, we discuss certain rules affecting the taxation of individuals, notably the treatment of interest and dividend income and the taxation of capital gains. At the same time, we make certain observations concerning employees' stock ownerships plans and venture capital corporations.

PART ONE

GENERAL RULES CONCERNING CORPORATE TAX RATES AND THE COMPUTATION OF INCOME

Tax Rates for Corporations. Section 123 ITA provides for a general rate of corporate tax for the 1976 and subsequent taxation years of 46%. This rate is reduced by a provincial abatement of 10% in respect of income earned in a province: sub-section 124(1) ITA. Each province in turn imposes a corporate income tax on income earned within the province at the following rates in 1976:

British Columbia, Newfoundland and Manitoba	13%
Quebec, Ontario and Saskatchewan	12%
Alberta	11%
Nova Scotia, Prince Edward Island, New Brunswick	10%

In the case of all provinces other than Ontario and Quebec, the provincial corporate tax is collected for the province by the Department of National Revenue.

Recent Reductions and Surtaxes. In recent years fiscal measures of general application to corporations have been adopted on two occasions. For the 18 month period from July 1, 1971, to December 31, 1972, the corporate tax rate was reduced by seven percentage points: Section 123.1 ITA. For the 12 month period from May 1, 1974, to April 30, 1975, a surtax of 10% was imposed by Section 123.2 ITA on the income tax otherwise payable by a corporation other than a number of special types of corporation such as investment corporations, mortgage investment corporations, mutual fund corporations, deposit insurance corporations, non-resident owned investment corporations and corporations entitled to the small business deduction. In addition the surtax was not applied in respect of Canadian manufacturing and processing profits eligible for the tax abatement under Section 125.1 ITA, the investment income of private corporations and certain resource profits which at the time were subject to a special tax regime.

Corporations Exempt from Income Tax. Section 149 ITA exempts a certain number of corporations from tax. The categories of corporation to which this exemption generally extends include municipalities, crown corporations, charitable corporations, low-cost housing corporations, non-profit corporations for scientific research, mutual insurance corporations, limited dividend housing corporations and farmers' and fishermen's insurers. As regards crown corporations, Section 27 ITA withdraws the exemption from tax otherwise granted by Section 149 ITA from those corporations which are listed in Schedule D to the Financial Administration Act.

Small Business Deduction. One provision of the Income Tax Act that is specifically designed to encourage the growth of smaller corporations is the small business deduction permitted by Section 125 ITA. It will be recalled that before 1972 corporations were subject to tax at approximately 21% on the first $35,000 of their taxable income and at 50% on the balance. The White Paper on Tax Reform recommended that this dual rate be eliminated in the cause of equity between incorporated and unincorporated businesses. However, in the face of strong public reaction, the dual rate was continued, but in a modified form. The present rule may be summarized as follows:

a) The low rate of tax is 25% on qualifying income.

b) It is only available to Canadian-controlled private corporations: that is to say it may not be claimed by non-resident corporations, by public corporations, or by corporations controlled by public corporations, by non-residents or by a combination of both. A public corporation is one whose shares are listed on a prescribed stock exchange in Canada, or whose shares are of a class which meets certain requirements as to its dispersal where the corporation has elected to be or has been designated a public corporation by the Minister of National Revenue.

c) The low rate is restricted to income derived from an active business carried on in Canada.

d) The low rate is limited to $100,000 of active business income for the year for each company or group of associated companies. This limit is to rise to $150,000 for the 1976 and subsequent taxation years pursuant to the Budget of May 25, 1976.

e) The low rate may no longer be claimed once the company or group of companies has earned a cumulative total of $500,000 of active business income since its 1971 taxation year, whether or not that income has benefited from the reduced rate of tax. Thus, if it reaches this limit in one year, the annual limit will still apply, and the benefit of the deduction will be lost thereafter, unless the company pays taxable dividends. The cumulative limit is to be raised to $750,000 pursuant to the Budget of May 25, 1976. Cumulative active business income is reduced in respect of taxable dividends distributed by the company or group of companies to shareholders other than associated corporations.

f) Where control of a Canadian-controlled private corporation is transferred to non-residents of Canada, any tax saving previously realised by way of the small business deduction must be repaid to the Department of National Revenue over a period of five years: Section 190 ITA.

g) Dividends paid out of earnings which benefitted from the small business deduction receive the same gross-up and credit treatment in the hands of individual shareholders as dividends paid out of fully taxed earnings.

h) Certain provinces, notably Ontario and British Columbia, grant an additional small business deduction in respect of active business income earned in the province.

COMMENTS

The small business deduction is only available to Canadian-controlled private corporations, so that as an incentive to the growth of small corporations, its impact is limited to that sector of the economy.

The small business deduction is lost once a corporation has reached its cumulative limit, unless it distributes its earnings by way of taxable dividends. Such dividends will be taxed at an effective rate (after the gross-up and credit) of up to 50%. Once a corporation has earned its cumulative limit, the benefit is effectively lost. Indeed, if it pays dividends in order to retain the benefit of the deduction, it may actually harm its potential for growth.

If the cumulative limit were abolished, all Canadian-controlled private corporations, large or small, could claim the small business deduction up to the annual limit. Relatively speaking, the deduction would remain more meaningful for smaller companies than for larger ones. In the following Chapter, we discuss the present distinction between public and private corporations and the possibility of a new distinction more closely based on size. If this were done, 'small' corporations alone could be granted the small business deduction, without cumulative limit.

Alternatively, consideration might be given to permitting Canadian-controlled private corporations to reduce their cumulative limit and to maintain their continuing right to claim the small business deduction by reinvesting earnings in business assets in Canada, as well as by the payment of taxable dividends. Precedents for this approach may be found in the investment allowance in respect of the branch tax payable by non-Canadian corporations carrying on business in Canada, and in the concept of earned depletion.

Low Tax on Manufacturing and Processing Profits. Section 125.1 ITA reduces the corporate tax rate for 1976 and subsequent taxation years by six percentage points in respect of Canadian manufacturing and processing profits. As a general rule these profits are subject to federal tax of 40%, less the provincial abatement of 10%. This incentive is available to all corporations whether public or private, and whether Canadian- or foreign-owned. By way of exception, when profits are eligible for the small business deduction, the reduction of tax under Section 125.1 ITA is limited to 5% and the applicable federal tax rate becomes 20%, less the provincial abatement of 10%. Canadian manufacturing and processing profits are defined in such a way as to exclude profits from farming, fishing, logging, construction and most forms of oil, gas and mineral exploitation.

COMMENTS

The reduction of tax on manufacturing and processing profits has benefitted companies of all sizes, although in terms of absolute dollars it is probable that Canada's larger companies have benefitted most.

A new differential between the treatment of Canadian-controlled private corporations and others could be introduced, if desired, so as to grant a greater reduction of tax on manufacturing and processing profits to the former than to the latter.

The reduced rate could also be extended to those sectors of tertiary industry which either provide services to or create opportunities for secondary industry, such as consultants to industry and consulting engineers.

Foreign Tax Credit. Section 126 ITA grants a foreign tax credit on a country-by-country basis, distinguishing between non-business income and business income. In both cases, the amount deductible from Canadian tax otherwise payable is basically limited to the lesser of the foreign tax paid and the Canadian tax applicable, on a proportionate basis, to the relevant foreign income, the calculation being made separately for each country involved. Unlike the non-business income tax credit, any unused credit for foreign business income tax may be carried forward five years. Special rules contained in Sections 91 and 113 ITA provide recognition for the foreign taxes borne by foreign affiliates of a Canadian corporation.

Investment Tax Credit. In 1975 an investment tax credit was introduced by subsection 127(5) ITA as an additional incentive to stimulate new investment in Canada. The credit is a deduction from the tax otherwise payable by an individual or corporation of 5% of the taxpayer's investment in new buildings, machinery or equipment acquired after June 23, 1975, and before July 1, 1977, to be used in Canada primarily for the purpose of manufacturing or processing, operating an oil or gas well, extracting minerals, processing ore to the prime metal stage, exploring or drilling for petroleum or natural gas, prospecting or exploring for minerals, logging, farming, fishing, or grain storage. The amount of the credit cannot exceed $15,000 plus one-half of the amount of the tax otherwise payable by the taxpayer in excess of $15,000 in any year. Any unused credit may be carried forward as a deduction from federal tax in the succeeding five years. The original capital cost of assets giving rise to the credit appears to be reduced by the amount of the credit under subsection 13 (7.1) ITA.

COMMENTS

Since the amount of the investment tax credit cannot exceed $15,000 plus one-half of the amount of the tax otherwise payable by the taxpayer in excess of $15,000 in any year, it might be said that the credit is more favourable to small corporations. However, as a practical matter, it may be that the credit is more meaningful to large corporations, since they are more likely to make investments of significant size.

If it were desired to increase the significance of the investment tax credit for smaller corporations, one might consider increasing the rate of the credit for them.

Interest Expenses. Paragraphs 20(1)(c) and (d) ITA generally permit a taxpayer to deduct a reasonable amount in respect of interest paid or payable in the year, depending on whether its accounts are kept on the cash or accrual method, provided the interest is payable on borrowed money used to earn income or relates to the acquisition of property with a view to gaining or producing income which is not exempt. An exception to the above rule is the thin capitalization provision contained in subsection 18(4) ITA, which limits the deductibility of interest paid to a 25% or more non-resident shareholder or to a related non-resident party on debt to the extent that it exceeds three times its paid-up capital limit and all its tax surpluses. Since 1972, interest paid on money borrowed to acquire shares in another corporation is deductible in the computation of income in accordance with the normal rules.

COMMENTS

The deductibility of interest is of equal benefit to large corporations and small. However, a related question concerns the use of lease financing, which can be of particular interest to smaller corporations not having access to the conventional money markets. On a lease financing, the financing company providing funds for the acquisition by a company of capital equipment generally purchases that equipment itself and then leases it to the company which will use the equipment, for a rent extending over the equipment's useful life. At the end of the lease, it is customary to provide that the lessee of the equipment has the option to acquire that equipment at its then residual value. In such cases, the Department of National Revenue may be concerned if the rent paid by the lessee for the equipment is deducted from its income as rent and not as depreciation, as it is therefore not subject to recapture should the lessee ever dispose of the equipment. For this reason, the Department views not as a lease but as a purchase any leasing transaction in which the option price is so low as to render the exercise of the option a foregone conclusion. At the same time, it views the rent which has been paid not as rent, but rather as the capital cost of depreciable property, and therefore subject to recapture to the extent claimed as depreciation. In his recent Budget, the Minister of Finance indicated that he would move to prevent capital cost allowance from being claimed in respect of leased moveable property in such a way as to create a loss which could be used to offset non-leasing income.

Perhaps lease financing techniques could be made more accessible to taxpayers, and at the same time a way could be found to satisfy the Department's concerns. In particular, the Act might be amended so that an appropriate portion of the rent payable for equipment purchased under a lease financing arrangement would be regarded as depreciation for purposes of recapture in respect of any depreciable property acquired under a lease-option.

"Goodwill". Before 1972 there was a limited class of expenditures which were neither depreciable nor deductible. In particular, these included incorporation expenses, and the cost of acquisition

of assets of an intangible nature, such as goodwill, certain customers' lists, and franchises for an unlimited period. Section 14 ITA now permits one-half of these expenditures to be amortized at a rate of 10% per year computed on a diminishing balance basis and at the same time provides that one-half of the proceeds of disposition of such assets is to be credited to the unamortized pool of expenses, and to the extent of the balance, brought into income.

COMMENTS

The provisions of Section 14 ITA do not constitute a particularly favourable treatment of the expenditures to which they apply. Recent court cases have tended to permit the deduction in full of such expenses where incurred by corporations in the normal ongoing conduct of their business or where they relate to an abortive project. Thus in 1971, the Federal Court of Canada permitted the deduction of the cost of studies undertaken to explore means of further exploiting the taxpayer's water rights and to look into the feasibility of installing thermal power in Bowater Power Company Ltd. v. M.N.R. (1971) C.T.C. 818. More recently, the Federal Court held, in M.P. Drilling Ltd. v. M.N.R. (1974) C.T.C. 426 (affirmed by the Federal Court of Appeal: (1976) C.T.C. 58) that a taxpayer in the business of drilling for oil could deduct amounts expended by it in unsuccessfully attempting to get into the business of marketing propane and butane gas abroad. As a matter of law, it would seem that established companies who incur expenses of this general nature are more likely to be able to deduct them in full than are newly incorporated entities. Consideration might be given to replacing the rather complex provisions of Section 14 ITA by provisions authorizing all taxpayers to deduct start-up expenses, and other costs of acquisition of assets of an intangible nature, on a current basis.

Depreciation. In his Budget Speech of May 25, 1976, the Minister of Finance indicated that the Government's recent review of the Canadian capital cost allowance system had been completed and that no fundamental changes to the existing rates of depreciation were contemplated. Thus, the cost of depreciable property is depreciable at a variety of rates set forth in the Income Tax Regulations on a class-by-class basis. When a depreciable asset is disposed of the proceeds of disposition up to the original capital cost of the asset are credited to the class, and to the extent that the class is brought into credit balance, included in income. Under the recent Budget proposals, such a credit balance will give rise to recapture even without the disposition of an asset.

The depreciation system may be used to provide incentives for certain types of investment. Thus, the rate of depreciation for manufacturing or processing machinery or equipment is normally 20%, but may be 50% straight-line if the equipment was acquired after May 8, 1972. In the recent Budget, a two-year fast write-off for certain types of equipment which contribute to the efficient use of energy resources is proposed. Generous write-offs for buildings put up in designated areas, and for anti-pollution equipment, are further examples of the use of accelerated depreciation rates to promote certain public policies.

COMMENTS

The basic structure of the capital cost allowance system is neutral as between large corporations and small. In practice, a small corporation may not have sufficient income in the year to utilize the full allowance to which it is entitled. Further, a deduction from income in respect of depreciation may be of greater value to it when it pays tax at the standard rate than when it pays tax at a reduced rate. For instance, a corporation benefitting from the small business deduction, but anticipating that it will no longer be entitled to claim the deduction in future years, may well decide to defer claiming capital cost allowance until such time as it becomes subject to tax at general corporate rates.

Research and Development Expenditures. Current scientific research expenditures made in Canada or abroad, and capital scientific research expenditures made in Canada, may be deducted by a taxpayer in the year or in any subsequent year under Section 37 ITA. Certain governmental grants received by the taxpayer in respect of scientific research reduce the amount of the deductible expenditure, but amounts of such grants rapid may be deducted from income.

Branch Tax. Section 219 ITA imposes a special tax on the post-tax profits of non-Canadian corporations gained from carrying on business in Canada. This tax is in lieu of the withholding tax which would otherwise be applied were that business to be carried on through an incorporated Canadian subsidiary which then distributed its post-tax earnings by way of dividend. The branch tax is generally levied at the same rate as that of the non-resident dividend withholding tax, namely 25% since the beginning of 1976. However, in the Budget of May 25, 1976, it is proposed that the rate of branch tax imposed on a non-Canadian corporation resident in a country with which Canada has a comprehensive income tax agreement be reduced to the maximum rate of Canadian withholding tax applicable to dividends covered by the agreement, generally 15%. The branch tax is applicable to a corporation's post-tax earnings in the year less certain items, notably an allowance in respect of earnings reinvested in qualifying Canadian assets.

Special Rules Applicable to Oil and Gas and Mining Industries. The taxation of the profits of oil, gas and mining companies is characterized by three special rules which may be summarized as follows:

a) Pre-production expenses are segregated into two categories. Canadian Exploration Expense may be written off entirely by principal-business corporations and at the annual rate of 30% by all other taxpayers. (Under the Budget of May 25, 1976, taxpayers other than principal-business corporations will be entitled to write off such expenses, if incurred up to July, 1979, at an annual rate of up to 100%). Canadian Development Expense may only be written off at the annual rate of 30%. The former category includes such pre-production expenses as the

costs of carrying on geological, geophysical, or geochemical surveys, drilling dry holes or capped wells, and prospecting. The latter category includes the costs of drilling in proven areas and acquiring Canadian resource properties, and is reduced by the proceeds of disposition of Canadian resource properties in such a way that if the pool of expenses is thrown into credit balance, that balance is brought into income: Sections 59, 66.1 and 66.2 ITA.

b) An earned depletion allowance is granted to taxpayers earning income from an oil or gas well or a mineral resource, the amount of the allowance being limited to the lesser of 25% of that income and one-third of the costs of exploring for or developing Canadian resource properties, including the cost of certain prescribed capital property and pre-production expenditures up to the prime metal stage or its equivalent: Section 65 ITA.

c) Crown royalties and a variety of other payments made to federal and provincial governments or agencies are disallowed as expenditures or added back to income, but an offsetting 'resource allowance' may be deducted from income, equal to 25% of the taxpayer's resource profits calculated before the deduction of pre-production expenses, interest and depletion: paragraphs 12(1)(o), 18(1)(m) and 20(1)(v.1) ITA.

Tax Losses. Section 111 ITA contains provisions under which certain losses sustained in a taxation year may be carried back or forward to another taxation year in computing the taxable income for that other year. Thus, non-capital losses, to the extent non-deductible from other income of the same year, may be carried back one year and forward five years. On the other hand, net capital losses may be carried back one year and forward indefinitely, but to the extent only of the net taxable capital gains (and, in the case of an individual, $1,000 of other income) realized in such other years.

However, upon the acquisition of control of a corporation by a person, the corporation's net capital losses, carried forward from its previous taxation years at the end of which it was not controlled by that person, lapse: subsection 111(4) ITA. The same rule applies to losses from a business, except that these do not lapse as long as that particular business is still being carried on by the corporation: subsection 111(5) ITA.

COMMENTS

Although the matter is occasionally the subject of speculation, in our experience, tax losses rarely if ever lead to the takeover of the loss company by a third party.

<u>Consolidated Returns</u>. There are no provisions in the Act which would permit the filing of a consolidated tax return by members of a corporate group.

COMMENTS

The lack of provisions in the Act permitting the filing of consolidated returns may act as an incentive for the elimination of separate corporate entities within a corporate group, and their replacement by separate operational divisions of the same corporate entity. In this way, losses from one business can be used to offset income from another business. Consideration could be given to permitting the payment of tax on a consolidated basis by all corporations resident in Canada and coming within the same corporate group.

PART TWO

CORPORATIONS AND THEIR SHAREHOLDERS, AND THE DISTINCTION BETWEEN PUBLIC AND PRIVATE CORPORATIONS

Introduction. Prior to 1972 the Act required that all ordinary dividends and deemed dividends (such as on the winding-up or re-organization of the business of a corporation), be included in a shareholder's income to the extent of the corporation's after-tax earnings. The corporation's remaining surplus could only be returned to its shareholders free of tax after its undistributed income on hand had been distributed.

In 1972 the Act was changed significantly, so as to provide as follows:

a) A corporation can effect a tax-free return of its paid-up capital at any time to its shareholders.

b) Pre-1972 surpluses of a Canadian corporation may be distributed to shareholders by way of the special procedures set out in subsection 83(1) ITA. These rules apply to dividends paid out of 'tax-paid undistributed surplus on hand' and '1971 capital surplus on hand' (these expressions are explained below). Such dividends are not included in the shareholder's income, but reduce the adjusted cost base of the shares on which the dividends are paid.

c) Each private corporation has a capital dividend account, essentially made up of one-half of its net capital gains, from which it may distribute capital dividends free of tax to its shareholders. Such dividends do not reduce the adjusted cost base of the corporation's shares: subsection 83(2) ITA.

d) All other dividends or distributions deemed to be dividends, including stock dividends, are generally treated as ordinary taxable dividends and are included in income.

Paid-up Capital, Paid-up Capital Deficiency, Paid-up Capital Limit and Debt Limit. As stated above, a corporation may effect a return of its paid-up capital tax-free to its shareholders at any time regardless of whether or not it has undistributed surplus on hand. Complex rules are provided to avoid an undue or artificial creation of paid-up capital, and to ensure that potentially taxable retained earnings are not paid to shareholders in the form of a return of capital. The concepts of "paid-up capital deficiency" and "paid-up capital limit" form part of these rules.

In addition to paid-up capital as understood in the corporate sense, the 'paid-up capital' of a corporation for income tax purposes includes most contributed surplus.

The 'paid-up capital limit' of a corporation is basically the amount of its 'paid-up capital' for tax purposes, less its 'paid-up capital deficiency', if any. The paid-up capital limit determines the extent to which a return of capital may be made by a corporation free of tax.

Essentially, the 'paid-up capital deficiency' of a corporation is the amount by which its 'paid-up capital' at the end of its 1971 taxation year plus its undistributed income on hand as computed under the old Act for its taxation years, 1950 to 1971, exceeds the net tax value of its assets at the end of its 1971 taxation year. A corporation's paid-up capital deficiency may fluctuate due to transactions occurring after its 1971 taxation year, notably certain transfers to controlled corporations, realizations of gains and losses on assets held at the end of 1971, the utilization of pre-1972 business losses and reductions of capital after 1971.

Basically, the paid-up capital deficiency rules ensure that non-deductible losses accrued to the end of 1971, and the tax 'deficit' resulting from the absence of sufficient property recognized for tax purposes in 1971, reduce first the amount that shareholders may receive tax-free as a return of capital, before diminishing the post-1971 taxable surplus available for distribution as a dividend.

The paid-up capital deficiency rules also have another purpose. Where the shares of a corporation are exchanged for shares of another corporation, all or part of the taxable surplus of the acquired corporation may be 'capitalized' in the acquiring corporation. In order to prevent the "artificial" creation of such surplus in certain instances, the Act provides that where shares are issued as part of a rollover transaction to which Section 85 ITA applies or where shares are issued as consideration for the purchase of shares of another corporation (if both corporations are controlled or substantially held by the same person or group of persons), a paid-up capital deficiency may arise which will offset all or part of the increased paid-up capital in the acquiring corporation. This rule ensures that a reorganization to which it applies will not result in an increased amount being available to shareholders as a capital return.

The concept of paid-up capital limit extends also to debt which a corporation may issue as consideration for the acquisition of shares of another corporation where both corporations were controlled or substantially owned by the same person or group of persons. In this way, a corporation is prevented from "artificially" converting surplus to capital through the use of

non-arm's length transfers involving debt: Section 84.1 ITA. Where the consideration for the transfer includes both shares and debt, the conversion of surplus into capital is prevented by complementary rules contained in sections 84.1 and paragraph 89(1)(d) ITA in the following manner. First, the paid-up capital deficiency is increased to reduce any newly-created paid-up capital on the shares of the corporation; if the paid-up capital deficiency does not completely offset the amount of surplus which would artificially be converted to capital, the balance, if any, constitutes a sort of debt deficiency which is deducted from the principal amount of the debt incurred as consideration for such transfer in computing the amount which can be returned to the corporation's creditors as capital, free of tax.

The "debt limit" represents the portion of the debt which is allowed to be returned tax-free. Any repayment above the debt limit is deemed to constitute a dividend. The amount of the dividend is excluded from the proceeds of disposition of the debt and to that extent, a capital loss may be incurred. Provision is also made for the conversion of the debt deficiency into paid-up capital deficiency upon a conversion of any portion of the debt into shares of the debtor corporation.

Rules Relating to Pre-1972 Surplus. Special rules govern the surpluses of public and private Canadian corporations accumulated prior to 1972. Basically, these rules are intended to preserve the character of these surpluses and to facilitate their distribution. Pre-1972 surplus is divided into 1971 undistributed income on hand ("UIOH") and 1971 capital surplus on hand ("CSOH").

1971 UIOH includes in general terms the total undistributed income (net of certain prescribed losses, taxes, expenses and other disbursements) earned by a corporation in its taxation years 1950 to 1971, together with specified amounts received from the 1971 UIOH of a controlled subsidiary, less the amount of tax-paid undistributed income at the end of 1971, as computed under the old Act, and all amounts converted into tax-paid undistributed surplus (TPUS) after 1971: subsection 196(4) ITA.

A corporation may elect to convert either a specified portion or the full amount of its 1971 UIOH to TPUS by filing an appropriate election and paying a tax of 15%: Section 196 ITA.

A Canadian corporation may then elect in prescribed manner to pay all or a portion of its TPUS by way of a dividend to its shareholders: subsection 83(1) ITA. Whether it is paid to an individual or to a corporation, such a dividend is not included in the income of the recipient. If it is paid to a non-resident, no withholding tax applies. In the case of dividends paid to a corporation, the TPUS retains its pre-1972 character in one of two ways. If a dividend is paid out of TPUS by a controlled corporation to its parent corporation, the latter may claim a refund of the 15% tax paid (providing it complies with certain requirements), whereupon

the amount of the dividend plus the reclaimed tax will fall into the parent corporation's 1971 UIOH: subsections 196(2) and (4) ITA. In any other case, the dividend is included in the recipient corporation's TPUS by virtue of paragraph 89(1)(h) ITA.

1971 CSOH essentially consists of the net tax value of a corporation's assets as at the end of its 1971 taxation year, plus dividends received from other corporations out of their 1971 CSOH, and plus that part of any gain actually realized by the corporation on the disposition of capital property held by it at the end of 1971 that can be attributed to the period preceding 1972, less the corporation's paid-up capital at the end of its 1971 taxation year, its 1971 UIOH, the amount of any dividends paid out of its 1971 CSOH, and that part of any loss actually realized by it on the disposition of capital property held by it at the end of 1971 that can be attributed to the period preceding 1972: paragraph 89(1)(e) ITA.

The 1971 CSOH of a Canadian corporation may be distributed by way of dividend to its shareholders without being included in their income and subjected to tax: subsection 83(1) ITA. Where such distributions are made to non-residents of Canada, no withholding tax is payable. However, 1971 CSOH dividends may only be paid by a corporation if at the time it has no 1971 UIOH. If the dividend is paid to a Canadian corporation, it is included in the recipient's 1971 CSOH, thereby preserving its tax-free status.

Although a shareholder receiving dividends from either TPUS or 1971 CSOH incurs no immediate tax cost, he must reduce the adjusted base of his shares in the corporation paying the dividend by the amount of the dividend received. If he later disposes of the shares for proceeds of disposition in excess of their reduced adjusted cost base he will realize a capital gain. Moreover, if through receipt of such dividends, the adjusted cost base of the shareholder's shares is reduced to a negative figure, a capital gain will be triggered equal to the negative amount: subsection 40(3) ITA. Substantial penalties are levied on a corporation where the dividend which it has elected to have treated as a non-taxable dividend exceeds the portion thereof that is deemed to be payable out of the appropriate pre-1972 surplus accounts: Section 184 ITA.

Comments

Canadian corporations which had accumulated substantial retained earnings and unrealized capital gains prior to 1972 now find themselves in the position where they may create tax-paid surpluses at relatively little expense, and raise additional equity capital in Canada by offering shares paying 'tax-free' dividends to the public. (In reality, these dividends may be more accurately described as 'tax-deferred' since they reduce the adjusted cost base of the shares on which they are paid, thereby exposing the

shareholder to a potential tax liability on his capital gains when eventually, he disposes of his shares). Several public Canadian corporations have two classes of common shares, with reciprocal convertibility, that are equal in all respects except that on one class of share taxable dividends are paid, whilst on the other class of share 'tax-free' (or 'tax-deferred') dividends are paid. Similarly, it is possible for a corporation with tax-free surplus to issue a new class of common or preferred shares on which dividends out of tax-free surplus are to be paid. Thus, although the rules relating to pre-1972 surplus are an inevitable outcome of Tax Reform, they tend to operate in favour of long-established corporations.

Taxation of Capital Dividends Paid by a Private Corporation. Subsection 83(2) ITA provides a means whereby the non-taxable half of the net capital gains realized by a private corporation may be accumulated in its capital dividend account and distributed free of tax to its shareholders. This provision together with the rules governing the taxation of capital gains realized by a private corporation results in an integration of taxation of capital gains at the level of both the private corporation and its individual Canadian resident shareholders (see the discussion below regarding the taxation of capital gains realized by a private corporation).

A private corporation's capital dividend account generally includes one-half of the amount of a corporation's capital gains less capital losses accrued and realized after 1971, together with capital dividends received from other private corporations, one-half of the portion of net gains realized after 1971 on the disposition of goodwill and other intangibles that is recognized for tax purposes and life insurance proceeds received by the corporation after 1971 net of any premiums paid, less the amount of any capital dividends previously payable by the corporation.

A private corporation may, upon making the appropriate election, declare and pay a dividend from its capital dividend account. Prior to declaring such a dividend, it must ensure that any 1971 UIOH has been converted to TPUS, as the dividend is only deemed to be a capital dividend to the extent that it exceeds the corporation's 1971 UIOH.

As in the case of dividends declared from pre-1972 surpluses, capital dividends are not included in the income of a resident Canadian shareholder and subjected to tax. However, unlike dividends from pre-1972 surpluses, a capital dividend will not reduce the adjusted cost base of the recipient shareholder's shares. If a capital dividend is received by a private corporation the amount of the dividend is added to its capital dividend account by virtue of paragraph 89(1)(b) ITA. Non-resident shareholders receiving a capital dividend are liable for withholding tax thereon. As in the case of dividends from pre-1972 surplus, substantial penalties may be levied where excess capital dividends are declared: subsection 184(2) ITA.

Comments

The provisions which enable a private corporation to pay a tax-free capital dividend are but one instance of the greater degree of integration of tax at the corporate and individual shareholder levels afforded to private corporations than to public corporations. This is discussed more fully below. When a private corporation becomes a public corporation, its capital dividend account and its capacity to pay capital dividends are eliminated. This rule can be an obstacle to a private corporation's going public, or at least an incentive for its realizing capital gains to the extent feasible and distributing amounts to clear out its capital dividend account prior to doing so.

The Taxation of Ordinary Dividends Received by Corporations Resident in Canada. In general, all taxable dividends received by a corporation from corporations resident in Canada are included in the recipient corporation's income: paragraph 82(1)(a) and 12(1)(j) ITA. However, a corporate shareholder which receives a taxable dividend from a taxable Canadian corporation or a controlled corporation resident in Canada (other than a non-resident-owned investment corporation) may deduct the amount of the dividend in computing its taxable income: subsection 112(1) ITA. Thus, such dividends will normally pass between corporations free of tax. However, where the recipient corporation is a private corporation, a special refundable tax of 33 1/3% of the dividend may be exigible. This tax is discussed below.

Section 90 ITA requires the inclusion in income by a shareholder of all dividends received from a corporation not resident in Canada: paragraph 12(1)(k) ITA. Special rules impute the income other than active business income of a controlled foreign affiliate of a Canadian taxpayer to that taxpayer at the end of the relevant fiscal year of the controlled foreign affiliate: Section 91 ITA.

A corporation which receives dividends from a non-resident corporation (other than a foreign affiliate) which is subject to Canadian tax under subsection 2(3) ITA in the year and which has throughout a prescribed period carried on business in Canada through a permanent establishment, may, in computing its taxable income, deduct the portion of the dividend it receives from such corporation which is attributable to its taxable income earned in Canada: subsection 112(2) ITA. Deductions are also permitted for specified amounts in respect of dividends received from a foreign affiliate: Sections 91 and 113 ITA.

Deemed Dividends. There are a number of provisions in the Income Tax Act which deem certain appropriations or distributions made by a corporation to or for the benefit of its shareholders to be dividends for tax purposes: subsections 15(2), 56(2), (3) and (4), 245(2). One of the most important of these deeming provisions is Section 84 ITA. Pursuant to that section, if a corporation resident in Canada increases its paid-up capital otherwise than by the payment of a stock dividend, without a corresponding increase in the value of its net assets, the amount of the excess is deemed to be a dividend.

Similarly, all distributions of funds or property made by a corporation resident in Canada upon the reorganization or liquidation of its business or upon the redemption, acquisition or cancellation of any of its shares, are deemed to constitute dividends to the extent that such distributions exceed the lesser of the paid-up capital of the shares of the corporation and its paid-up capital limit at that time. The deemed dividend reduces the corporation's paid-up capital deficiency and is excluded from the proceeds of disposition of its shares.

The same rule applies to any other reduction in the paid-up capital of a share. In such case, the adjusted cost base of the share is reduced by the amount returned as capital.

Stock Dividends   Stock dividends are taxed in the same way as ordinary dividends. The adjusted cost base of shares received by way of a stock dividend is equal to the amount of the dividend, that is, the amount by which the paid-up capital of the corporation was increased upon the issue of the shares: subsection 52(3) and 248(1) ITA.

COMMENTS

When a shareholder receives a stock dividend from a Canadian corporation he is taxed on the amount of the dividend as though it had been paid in cash, and yet all that he has done is increase his shareholding in the company. If stock dividends were not included in income, but proportionately reduced the adjusted cost base of all of the shareholders' shares in the company, a new method for raising additional capital could be opened to Canadian corporations. So long as a corporation's paid-up capital limit was not increased by the amount of the stock dividend, any retained earnings that were 'capitalized' upon the payment of the stock dividend would remain exposed to tax upon their ultimate distribution to shareholders.

The Distinction Between Public and Private Corporations. The Act distinguishes between public and private corporations in the following manner.

Public Corporation: paragraph 89(1)(g) ITA

A public corporation is a corporation resident in Canada if

(a) any class of its shares is listed on a Canadian stock exchange; or

(b) it has either elected or been designated by the Minister of National Revenue to be a public corporation, and at that time, it had a class of shares qualified for distribution to the public in respect of which the following two conditions were met:

(i) the number of shareholders: if the shares are equity shares, there must be at least 150, and otherwise 300, persons, other than insiders, holding not less than one 'block' of shares worth at least $500; a 'block' means 100 shares, if worth less than $25 each, 25 shares, if worth $25 or more, but less than $100 and 10 shares, if worth $100 or more.

(ii) dispersal of ownership of its shares: insiders may not hold more than 80% of the shares of the relevant class.

A public corporation may elect or be designated by the Minister of National Revenue to cease to be a public corporation where the number of its shareholders and the dispersal of ownership of its shares fall below certain limits.

Private Corporation: paragraph 89(1)(f) ITA

A private corpration is generally a corporation resident in Canada that is not a public corporation and is not controlled, directly or indirectly, by one or more public corporations. (The Canadian subsidiary of a foreign parent company whose shares were listed in its own country would nonetheless be a 'private corporation').

In the booklet PROPOSALS FOR TAX REFORM published by the Minister of Finance in 1969, the reasons for the distinction between public and private corporations were summarized as follows:

> "4.19 The government's proposal is to create one set of rules for the closely held corporation - the incorporated proprietorship or partnership - and another set of rules for the widely-held, public corporation. This distinction reflects the difference in the relationship between the two types of corporations and their respective shareholders. It also reflects the fact that, by and large, the closely-held corporation competes with proprietorships, partnerships and of course with other closely-held corporations, while the public corporation competes with other public corporations, both Canadian and foreign."

Two differences in the rules applicable to public and private corporations have already been discussed.

(a) Only private corporations (that are Canadian-controlled) can benefit from the small business deduction.

(b) Only private corporations can pay capital dividends.

Two further differences are that:

(a) approximately one-half the tax paid by a private corporation on its investment income (including taxable capital gains) is refunded to it when it pays dividends; and

(b) a special refundable tax of 33 1/3% is payable by a private corporation on certain taxable dividends received by it.

The Dividend Refund. Where investment income is received by a private corporation, the income becomes subject to tax in the normal manner. However, approximately one-half of the tax paid is included in a 'refundable dividend tax on hand' account, and may be refunded to the corporation when the income is distributed by way of taxable dividends to its shareholders: section 129 ITA. This refund may be claimed on the basis of $1.00 for every $3.00 of taxable dividends paid.

When a private corporation realizes a capital gain, one-half of that capital gain (the taxable capital gain) is regarded as investment income and is initially taxed at normal corporate rates. Once more, however, an amount equal to approximately one-half of the tax is included in the 'refundable dividend tax on hand' account of the corporation and may be refunded to it when it distributes the investment income to its shareholders by way of taxable dividends: Section 129 ITA.

As noted above, the other half of the capital gain realized by the private corporation (in theory, the non-taxable portion) may be included in its capital dividend account and may be distributed to its Canadian resident shareholders free of tax.

The investment income of a private corporation is fairly broadly defined. In effect, it includes all income other than income from an active business.

COMMENTS

The combined effect of the above rules and of the gross-up and credit mechanism governing the taxation of taxable dividends received by individuals is to achieve an almost perfect integration of tax at the corporate and individual shareholder levels in two instances, firstly, in the case of the profits of a Canadian-controlled private corporation benefiting from the small business deduction; secondly, in respect of the investment income of private corporations. On the other hand, only partial integration is achieved for profits from the active business of a public or private corporation that have been taxed at the standard rate of tax, and only partial integration is achieved in respect of the investment income earned and taxable capital gains realized by a public corporation. To illustrate the significance of this, we give the following simplified example of $100 income earned in four separate sets of circumstances, comparing the after-tax return to an individual shareholder paying tax at a marginal rate which is assumed to be 60%, and assuming that the basic corporate tax rate is 50%.

	(a) earned directly by individual	(b) subject to small business deduction	(c) investment income of private corp.	(d) ordinary corporate income
income to corp.	-	100	100	100
corporate tax	-	25	50	50
refundable tax	-	-	25	-
after tax dividend	-	75	75	50
income to shareholder	100	75	75	50
plus gross-up of 1/3	-	25	25	17
income tax at	100	100	100	67
60%	60	60	60	40
less credit	-	25	25	17
individual tax	60	35	35	23
after tax proceeds	40	40	40	27

The following illustrates the different treatment of a capital gain of $100 earned by a public and private corporation paying tax at an assumed corporate rate of 50%, and distributed to a shareholder taxed at a marginal rate of 60%.

	Individual	Public Corporation	Private Corporation
capital gain	100	100	100
taxable cap. gain	50	50	50
corporate tax	-	25	25
capital dividend	-	-	50
refundable tax	-	-	12.5
taxable dividend	-	75	37.5
income to shareholder	50	75	37.5
plus gross-up of 1/3	-	25	12.5
income subject to tax	50	100	50
tax at 60%	30	60	30
less credit (equal to gross-up)	-	25	12.5
tax	30	35	17.5
after tax proceeds	70	40	70

Clearly, there can be an important difference between the overall tax burden borne by shareholders of public and private corporations. Is it necessary to base this distinction on the different relationships assumed to exist between such corporations and their respective shareholders? If there is to be a difference, it could perhaps be equally well based on size.

Alternatively, perhaps the manner of calculating the gross-up and credit could be altered so as to achieve full integration in respect of corporate profits taxed at the standard corporate rate (at the same time, the dividend refund could be eliminated and all corporations could be permitted to pay capital dividends). Individual investment in Canadian corporations might thereby be rendered more attractive and the overall benefit of the small business deduction enhanced.

The Special Refundable Tax. When taxable dividends which are deductible from income pursuant to subsection 112(1) (or to the extent deductible pursuant to paragraphs 113(1)(a), (b) and (c) and subsection 113(2) ITA) are received by a private corporation, such dividends are subject to a special fully refundable tax of 33 1/3%: Section 186 ITA. This special tax will apply if either:

a) the receiving corporation does not control the paying corporation. For this purpose, a corporation is controlled by another corporation if more than 50% of its issued share capital (having full voting rights under all circumstances) is owned by the other corporation, by persons with whom the other corporation does not deal at arm's length or by the other corporation and persons with whom the other corporation does not deal at arm's length; or

b) the receiving corporation does control the paying corporation, and the paying corporation was entitled to a refund of special refundable tax in respect of the dividend.

As a general rule this special refundable tax is refunded to the private corporation which paid it to the extent that it in turn distributes taxable dividends to its shareholders. This refund amounts to $1.00 for every $3.00 of taxable dividends paid: Section 129 ITA.

COMMENTS

The special refundable tax is designed to anticipate the tax which would be payable on dividends received from taxable Canadian corporations by an individual, but which are received by a private corporation and escape tax under Part I of the Act by virtue of the deductibility of intercorporate dividends. The tax is only applicable in instances in which the corporation paying the dividend is not controlled by the private corporation receiving the dividend (unless the paying corporation is entitled to a refund of special refundable tax in respect of the dividend).

The rule can pose problems for joint venture companies, as can the absence of rules permitting the flow through of the expenses of such companies to their shareholders. Perhaps two or more Canadian resident corporations forming a company should be permitted at the outset to elect that all of its income and expenditures, profits and losses, tax accounts and the like would be attributed to them in the same proportions as their equity shareholdings, so that the joint venture corporation would be treated for tax purposes as though it did not exist, or as though it were a partnership.

Taxation of Dividends out of Designated Surplus. The Act contains a series of complex provisions governing the creation and taxation of "designated surplus" in a corporation resident in Canada.

These provisions were designed to prevent the avoidance of tax by the transfer of control of a corporation having potentially taxable surplus to another corporation in such a way as to allow the original shareholder to realize a capital gain rather than a normal distribution of income by way of dividend, while at the same time permitting the corporate transferee to extract the taxable surplus as a tax-free inter-corporate dividend.

In the practical sense, a corporation's surplus at the end of a taxation year becomes "designated" if at any time in the subsequent year control of the corporation, or of a corporation of which it is a subsidiary (the "controlled corporation") is acquired by another corporation (the "controlling corporation") and/or other persons with whom it does not deal at arm's length. It therefore appears that a controlling corporation need not hold any shares in a controlled corporation in order to designate the surplus of the controlled corporation and that all of the corporations forming part of a related corporate group control each other. For this reason, a transfer of a corporation within a corporate group will not give rise to further designated surplus.

If the controlling corporation receives a taxable dividend out of the designated surplus of a controlled corporation resident in Canada, it must pay a special tax of 25% on the amount of the dividend by virtue of Section 192 ITA. However, if the controlling corporation is not resident in Canada, or if it is a non-resident-owned investment corporation, the special tax is 15% and is borne by the corporation paying the dividend: Section 194 ITA. This is also true if the controlling corporation is exempt from tax, but in such a case, the special tax amounts to 33 1/3%. In all instances, the adjusted cost base of the shares held by the controlling corporation must be reduced by the amount of the dividend out of designated surplus less the amount of the special tax: paragraph 53(2)(a) ITA.

It should be noted that 1971 UIOH may also form part of the corporation's designated surplus, and the corporation may in effect convert such 1971 UIOH to TPUS by election under Section 196 ITA thereby eliminating such portion of its designated surplus. When this TPUS is paid out to a shareholder the special tax on designated surplus is not exigible, but the receiving corporation may not cause it to revert to 1971 UIOH and have the tax paid on the conversion refunded to it: subsection 196(2) ITA.

It should also be recalled that certain corporate actions may give rise to a deemed dividend, and where designated surplus exists, to the special tax.

COMMENTS

The rules regarding designated surplus can influence the manner in which Canadian corporations are acquired, merged or reorganized. The rules are perhaps less severe for existing corporations than for new ones, because of the possible overlap of 1971 UIOH and designated surplus. The Government has been urged on many occasions to remove the rules concerning designated surplus, particularly in light of provisions in the Act which permit it to attack dividend stripping transactions, and it is understood that the matter is presently under active consideration.

Anti-Dividend Stripping Provisions. Subsection 247(1) confers upon the Minister of National Revenue discretionary authority to levy tax in respect of certain corporate transactions which may be considered by him to have resulted in, or may in the future result in, avoidance of tax upon the distribution of a corporation's income. This provision was originally enacted in 1963 as a temporary measure to discourage the "dividend stripping" of corporate surpluses by the sale of shares, primarily by individuals seeking to avoid tax therein, to corporations able by one or more means to receive such surplus without tax.

COMMENTS

Subsection 247(1) is couched in such wide terms that many corporate transactions are potentially affected. If in the opinion of the Minister of National Revenue one of the purposes of any transaction or series of transactions is to effect a substantial reduction of the assets of any corporation in such a manner that tax which would otherwise be payable upon the distribution or its income is or will be avoided, he has the power to direct an amount he specifies to be included in the income of the taxpayer. This direction can be made against an individual or corporate taxpayer upon the receipt of any amount as consideration for the sale of shares, in consequence of the redemption or conversion of shares or otherwise as a payment that would be exempt income (including, in the case of a resident corporation, a deductible dividend received from another resident corporation).

The Department of National Revenue has in recent years developed certain guidelines in the application of this subsection and will issue no-action advance rulings in respect of transactions meeting those guidelines. However, the discretionary power to tax under subsection 247(1), has often inhibited normal corporate reorganizations and transactions.

Taxation of Dividends Paid or Credited to Non-Residents. Pursuant to subsection 212(2) ITA all ordinary taxable dividends and capital dividends paid or credited to a non-resident person are subject to withholding tax. On the other hand, dividends paid out of TPUS and 1971 CSOH do not attract withholding tax.

For 1976 and subsequent taxation years the rate of withholding tax levied on dividends paid or credited to non-residents is 25%, unless otherwise specified in one of Canada's bilateral income tax agreements.

At present the countries with which Canada has an income tax agreement are:

New Zealand	Finland
Sweden	Japan
France	Norway
West Germany	Trinidad and Tobago
South Africa	Jamaica
Netherlands	United States
Ireland	United Kingdom
Denmark	Belgium (to be ratified)
Australia	Israel (to be ratified)

In the case of a dividend paid by a corporation having a "degree of Canadian ownership", there is a 5% reduction of the rate of withholding tax otherwise applicable: subsection 212(3) ITA. For instance, the rate of tax applicable to a dividend paid by such a corporation to a shareholder resident in the United States or the United Kingdom is reduced from 15% (the rate generally provided for in the income tax agreement) to 10%.

A corporation is described as a "degree of Canadian ownership" when during a prescribed period it complies with certain requirements. Basically, these are that it is resident in Canada, at least 25% of its voting and equity shares are owned by individuals resident in or corporations controlled in Canada and at least 25% of its directors are resident in Canada: section 257 ITA.

COMMENTS

The reduction of five percent (5%) in the withholding tax applicable to dividends paid by corporations having a 'degree of Canadian ownership' has probably worked as an effective incentive, in certain cases, for foreign corporations to permit participation or greater participation by Canadians in their Canadian subsidiaries. The effect of this incentive might be prolonged and enhanced if the required percentage of Canadian ownership (25%) was gradually raised over a given period of time. At the same time, the present requirements which must be met to establish a 'degree of Canadian ownership' might be refined so as to permit members of multitiered corporate groups in Canada to qualify where there is a significant actual Canadian ownership.

Taxation of Interest Paid or Credited to Non-Residents. In general, interest paid or credited or deemed to be paid or credited by a Canadian resident to a non-resident is subject to withholding tax. Subject to certain exceptions, the rate of withholding tax for 1976 and subsequent taxation years is 25%; paragraph 212(1)(b) ITA.

In certain circumstances, however, the rate may either be reduced, or the payment exempted from withholding tax altogether. Chief amongst these are the following:

a) If the non-resident recipient is a resident of a country which has a bilateral income tax agreement with Canada, the rate may be reduced in the agreement, generally to 15%. If the rate is not reduced to or below 15%, but the country is designated in Part XVI of the Income Tax Regulations and if the interest is paid in respect of a bond, debenture, note, mortgage, hypothec or similar obligation issued before 1976 to the non-resident in an arm's length transaction, the rate of withholding tax is reduced to 15% by subsection 10(4) of the Income Tax Application Rules. The countries prescribed for this purpose are:

Australia	Norway
Federal Republic of Germany	Sweden
France	New Zealand
Ireland	Finland
Jamaica	South Africa
Japan	Trinidad and Tobago
Denmark	United States
Netherlands	United Kingdom

b) The rate of withholding tax on certain bonds or other obligations issued or guaranteed by a province of Canada on or before December 20, 1960 (or certain specified bonds exchanged for such bonds) is 5%: subsections 212(6), (7) and (8) ITA.

c) Interest paid in respect of certain obligations is exempt from withholding tax. The most important exemptions are those for:

  i) interest payable on bonds issued or guaranteed by the Government of Canada on or before December 20, 1960: clause 212(1)(b)(ii)(A) ITA;

  ii) interest payable on bonds issued or guaranteed by the Government of Canada after December 20, 1960 and before April 16, 1966 where the recipient of the interest is a government or central bank of a country other than Canada or an international organization or agency prescribed by regulation: clause 212(1)(b)(ii)(B) ITA;

iii) interest payable on bonds, debentures, notes, mortgages, hypothecs or similar obligations issued or guaranteed by the Government of Canada, the government of a province of Canada or agent thereof, a municipality in Canada, a municipal or public body performing a function of government in Canada, a corporation, commission or association not less than 90% owned by a province or a Canadian municipality or a wholly owned subsidiary corporation thereof or an educational institution or hospital in certain circumstances, issued after April 15, 1966 and before 1979: clause 212(1)(b)(ii)(C) ITA;

iv) where such bonds, debentures, notes, mortgages, hypothecs or similar obligations are issued after 1978, interest payable to a person resident in a prescribed country: subparagraph 212(1)(b)(vi) ITA;

v) interest payable in certain specified circumstances, notably on non-Canadian dollar deposits with a Canadian chartered bank, between persons dealing at arm's length where payment is required to be made in a currency other than Canadian funds: subparagraph 212(1)(b)(iii) ITA;

vi) interest payable by a corporation resident in Canada in respect of any obligation issued at arm's length after June 23, 1975 and before 1979 if under the terms of the obligation not more than 25% of the principal is repayable within 5 years of the date of its issue except in the event of failure or default: subparagraph 212(1)(b)(vii) ITA. In his recent Budget, the Minister of Finance indicated that there would be legislative changes clarifying the application of this provision to obligations issued in series as a single debt issue.

COMMENTS

It is perhaps the last-mentioned exemption, introduced in 1975, which is of the greatest significance to Canadian corporations. With Canadian interest rates chronically higher than international rates and credit-worthiness in international money markets effectively limited to government-owned and major publicly-listed corporations in Canada, the exemptions from withholding tax on interest paid to non-residents may be an important benefit to which smaller Canadian corporations have limited access. On the other hand, smaller corporations may benefit to the extent that pressure on available domestic funds, and hence interest rates, is reduced.

PART THREE

TRANSFER OF ASSETS, SHARE-FOR-SHARE EXCHANGES, AMALGAMATIONS, LIQUIDATIONS AND OTHER CORPORATE REORGANIZATIONS

Rules Relating to the Purchase and Sale of a Business. Many tax considerations enter into the decision of the vendor and purchaser of a business as to whether the transaction should involve assets or shares. Chief amongst these are the following.

A sale of shares will in almost all cases ensure capital gains treatment for the vendor, in effect subjecting him to tax on one-half of the gain accrued since December 31, 1971. If the proceeds are payable to him over several years, he may generally claim a reserve such that his gain will be spread over the period of payment. Further, an individual may achieve a forward averaging of his income by using an amount equal to all or part of his net taxable capital gain to purchase an income-averaging annuity contract. In such a case, the amount of the premium paid by him for the annuity may be deducted in computing his income, and annuity payments subsequently received by him will be included in full in his income: Sections 61 and 56 ITA.

A purchase of shares may, however, give rise to certain concerns for the purchaser. If the purchaser is a corporation, the acquired company's undistributed income at the end of its preceding taxation year, as well as that of its subsidiaries, will become designated, with the results noted above. Its net capital losses available to be carried forward from prior years will lapse, as will its business losses, unless it continues to carry on the same business. If the purchaser is, or is controlled by a non-resident person, any tax saving previously obtained by the acquired company by virtue of the small business deduction will generally have to be forfeited by way of a special tax payable over five years: Sections 190 and 191 ITA. If the purchaser is, or is controlled by a public corporation, the acquired company's refundable dividend tax on hand and capital dividend account will be wiped out.

A sale of assets by the company, where the vendor retains ownership of its shares will generally tend to put the vendor in a less favourable position than if he had sold shares. The price, including liabilities assumed by the purchaser, will have to be allocated amongst all assets sold, including goodwill. Thus depreciation claimed in prior years may be recaptured. Income may be realized upon the sale of inventory, accounts receivable in respect of which a reserve for doubtful debts has been claimed, prepaid expenses and similar items. Capital gains liability may well arise on the sale of capital assets, such as land and buildings. Up to one-half of the portion of the total price which is allocable

to goodwill will be credited to the company's unamortized pool of eligible capital expenditures, and to the extent that this pool is brought into credit balance, included in the company's income. A distribution of the company's after-tax proceeds of sale by way of dividend to its shareholders may give rise to further tax in their hands.

A purchase of assets may be attractive to the purchaser because it may result in an increase in the depreciable base of the depreciable property acquired over that which would have prevailed had he acquired the company's shares. Similarly, the cost base of capital property and inventory will now reflect their current value. One-half of the price attributable to goodwill will be available for amortization at the rate of ten per cent per annum on a diminishing balance basis. Further, the purchaser of assets does not inherit the tax problems which may be inherent in the company as a result of disputes that have arisen or could yet arise in respect of prior years with the tax authorities, or as a result of the make-up of its various surplus accounts for tax purposes.

On the other hand, provincial sales tax will generally apply to the sale price of all moveable property, although there are certain exemptions. Certain social security contributions, such as those of the employer and the employee under the Canada Pension Plan and the Quebec Pension Plan may have to be repeated in whole or in part in respect of the current calendar year.

Convertible Securities. Section 51 ITA defers the realization of a capital gain or loss on the conversion of a share, bond, debenture or note of a corporation into shares of that corporation, provided that no other consideration is received and that the right to effect the conversion of the instrument is conferred upon the shareholder by its terms.

A similar provision is found in Section 77 ITA which permits a tax-free exchange of a bond, convertible on its terms, for another bond of the same debtor, provided that the amount payable to the bondholder on its maturity remains the same.

Transfer of Property to a Corporation by a Shareholder. Section 85 ITA is an important rollover provision which is generally used on transfers within a corporate group. It allows a taxpayer to defer, within certain limits, the realization of a gain on the transfer of capital property (other than real property owned by a non-resident), inventory (other than real property), an asset of an intangible nature or a resource property to a Canadian corporation for a consideration including shares of that corporation. To this end, the taxpayer and the corporation must elect separately in respect of each asset being transferred, attributing a deemed transfer value to the asset which will then be the proceeds of disposition of the asset to the taxpayer, and its cost to the corporation. This value may only be selected within a certain range; generally, it will equal the tax cost of the asset to the taxpayer.

Exchange of Shares by a Shareholder in the Course of a Reorganization of Capital. Many reorganizations of the capital stock of a corporation, such as a reclassification or consolidation of its shares or a stock split, are not considered, as a matter of law, to give rise to a disposition by the shareholder of his shares. Where such a reorganization is considered to give rise to a disposition of shares, Section 86 ITA permits the shareholder to defer the realization of a capital gain. This provision is not applicable to a share conversion to which Section 51 ITA applies nor to a transfer in respect of which an election is filed under Section 85 ITA.

Amalgamations. Section 87 ITA provides for a fiscal continuity upon the amalgamation of two or more Canadian corporations to form a single successor corporation. Other 'mergers' occurring as a result of the acquisition of property of a corporation by another corporation, or the distribution of such property upon the winding-up of a corporation, are specifically excluded from the operation of this provision.

Section 87 ITA ensures a continuity of such things as trade accounts, reserves, tax costs, and tax surplus accounts from the predecessor corporations into the amalgamated corporation, with the notable exception that their tax losses may not be carried over into the new corporation. It also grants a rollover to the shareholders, option holders and bondholders of the predecessor corporations.

Liquidations. As a general rule, all distributions of funds or property upon the winding-up or liquidation of a corporation are deemed by Section 84 ITA to constitute a dividend, except for the return of its paid-up capital, or in case of any deficiency therein, its paid-up capital limit. At the same time, subsection 69(5) ITA provides that the corporation is deemed to have disposed of the property distributed to its shareholders for fair market value and that a shareholder is deemed to have acquired any property so distributed to him at a cost equal to that amount. If they are capital property to him, the shareholder is considered to have disposed of his shares, when these are cancelled, for proceeds equal to the value of all property received by him, less the amount of the deemed dividend: subparagraph 54(h)(ix) ITA.

Subsection 88(1) ITA contains more favourable rules, which are only applicable to the winding-up of a wholly owned Canadian subsidiary corporation into another Canadian corporation. These rules tend to defer tax upon the winding-up and to transfer the subsidiary's tax values and accounts to its parent in much the same manner as upon an amalgamation governed by Section 87 ITA. However, provision is made for the immediate taxation of the designated surplus of the subsidiary.

COMMENTS

It is not really possible to envisage any change to the tax system which would neutralize the differences to a vendor and purchaser on an acquisition of shares as opposed to an acquisition of assets. Similarly, it is difficult to conceive of a tax system in which the various rollovers provided by Sections 51, 85, 86, 87 and 88 ITA had less scope than they presently have, since they essentially apply to internal re-organizations. These provisions are all equally applicable to both large and small corporations.

Share-for-Share Exchange. Section 85.1 ITA is also an important rollover provision, of particular application in takeover bids where a Canadian corporation offers its own shares in consideration for the shares of another corporation. It affords a deferral in the recognition of any capital gain that would otherwise be realized by the shareholder disposing of his shares in exchange for shares of the Canadian corporation. At the same time, the Canadian corporation is deemed to have acquired the shares at a nil cost, except that if, upon the exchange or at any time thereafter, its share ownership in the acquired corporation represents at least 10% of both the voting power and the value of the acquired corporation's outstanding stock, that cost is deemed, from that time on, to be the fair market value of the shares immediately before the exchange. Section 85.1 does not apply if an election is filed under Section 85 ITA, and more significantly, its operation is restricted to an exchange between parties dealing at arm's length.

COMMENTS

The share-for-share exchange provisions of Section 85.1 ITA facilitate corporate acquisitions which are not internal reorganizations. As such, they may be viewed as favouring corporate concentration. The requirements in Section 85.1 that the purchasing corporation be at arm's length with the taxpayer acquiring shares of its capital stock in exchange for shares of the acquired corporation, immediately before such exchange, and, immediately thereafter, not be controlled or substantially owned - more than 50% of its paid-up capital - by that taxpayer and/or persons with whom he did not deal at arm's length, can preclude the use of the provision in certain types of situation. A further limitation is that the acquiring corporation must be a Canadian corporation, as defined in paragraph 89(1)(a) ITA to include most corporations resident in Canada.

If it was decided as a matter of policy that only certain forms of corporate concentration were to be encouraged, Section 85.1 could be modified so as to achieve this result. For example, only acquiring corporations demonstrating a substantial degree of Canadian ownership could be granted the benefits of the provision. Again, the rollover could be withheld in cases where the combined net worth of the two corporations exceeded a certain threshold limit. On the other hand, the requirement that the taxpayer disposing of his shares in the acquired corporation be at arm's length with the acquiring corporation immediately before the exchange and not control or substantially own it immediately thereafter could be eliminated.

Divesting Transactions. There are no provisions in the Act, (or for that matter in the Canada Business Corporations Act), which

would permit a corporation to be split into two continuing corporations sharing all of the fiscal and juridical attributes of their predecessor corporation, including the tax values of its depreciable and other capital assets and its tax surplus accounts.

COMMENTS

Whether such a transaction came about voluntarily or as a result of a Government order, it should be facilitated as a matter of both corporate and fiscal law in exactly the same way as an amalgamation. Special tax rules could defer the realization of capital gains at both the corporate and shareholder level.

PART FOUR

THE TAXATION OF INDIVIDUALS: EMPLOYEES' STOCK OWNERSHIP PLANS AND VENTURE CAPITAL CORPORATIONS

Taxation of Ordinary Dividends and Interest Received by an Individual. Taxable dividends distributed to an individual shareholder by a taxable Canadian corporation are included in his income in an amount equal to the actual amount of the dividend, as are those received from any other resident corporation, plus a gross-up of one-third of that amount: Section 82 and paragraph 12(1)(j) ITA. The shareholder then receives a federal dividend tax credit equal to four-fifths of the amount of the gross-up: Section 121 ITA. Generally, one-fifth of the gross-up is allowed by the Canadian provinces as a credit against provincial tax.

This gross-up and credit, in conjunction with the provision for capital dividends and with the rules providing a refund to a private corporation in respect of tax paid by it on investment income including capital gains, ensures that the overall tax paid by both a private corporation and its shareholders on investment income does not exceed the tax which would have been payable had the shareholders received the income directly. The gross-up and credit in conjunction with the small business deduction granted to Canadian-controlled private corporations ensures a similar integration in respect of income eligible for such deduction. In all other cases, the gross-up and credit only results in a partial reduction of the double taxation of income earned by a corporation and distributed to its shareholders.

Dividends received by individuals resident in Canada on shares of corporations not resident in Canada are included in income without gross-up or credit (except a credit for foreign withholding tax): Section 90 ITA.

Interest and other payments which are deemed to be interest are included in the income of an individual in the year in which the interest is either received or receivable (depending on the method regularly followed by the taxpayer in computing his income): paragraph 12(1)(c) and subsection 16(1) ITA.

Section 110.1 ITA permits an individual (other than a non-testamentary trust) who receives qualifying interest or dividend income in a particular year to deduct an amount equal to the lesser of $1,000.00 and the total qualifying interest and taxable dividends (grossed-up as the case may be) received. Qualifying interest includes most interest received by or attributed to a taxpayer in the particular year except interest from sources outside Canada, payments out of a registered retirement savings plan, deferred profit sharing plan, income averaging annuity contract or registered

pension fund or plan and interest paid where the payer and recipient do not deal at arm's length. Qualifying dividends include all taxable dividends received from a corporation resident in Canada with which the taxpayer deals at arm's length.

Provision is made for the transfer of the unused portion of the interest and dividend deduction to a taxpayer's spouse.

COMMENTS

In Chapter 3, we comment on the differing degrees of integration of tax at the corpoate and shareholder levels for public and private corporations.

The $1,000 deduction for individuals in respect of dividends and interest could be increased (or decreased) so as to provide a greater (or lesser) inducement for individuals to invest in securities.

The Taxation of Capital Gains and Losses of Individuals. One-half of the capital gains less capital losses of a taxpayer are brought into income, but only to the extent that they have accrued since 1971. A notable exemption exists in favour of a taxpayer's principal residence, which may normally be disposed of without taxable gain or allowable loss.

A gain or loss may be realized upon the actual disposition of a capital property, upon its transfer at death or by gift or upon its deemed transfer when the taxpayer ceases to reside in Canada, in which cases the transfer is deemed to be for proceeds equal to fair market value.

In computing his capital gain or loss, a taxpayer may deduct from his proceeds of disposition any expenses relating thereto. He may also deduct the adjusted cost base of the property, which is the historic cost of the property, plus or minus one or more adjustments. For instance, certain 'tax-free' dividends reduce the adjusted cost base of the shares on which they are paid. Special rules are also provided in the case of property held prior to 1972 and disposed of after 1971. Basically these rules ensure that only the appreciation or depreciation in value of a capital property accruing after 1971 will be treated as a capital gain or loss.

The allowable capital losses of an individual in a year may be deducted from his taxable capital gains. If they exceed such gains, the excess may only be deducted from other income for the year to the extent of $1,000. Any unabsorbed allowable capital losses may be carried back one year and forward indefinitely to reduce taxable capital gains, and up to $1,000 of other income in each year. In the case of a corporate taxpayer, allowable capital losses may never offset income other than taxable capital gains.

Non-residents of Canada are taxed in the same manner as residents of Canada in respect of their taxable capital gains and allowable capital losses, but only in respect of dispositions of certain properties described in the Act as "taxable Canadian

properties". Certain income tax agreements reduce or eliminate this liability in respect of non-resident persons covered by the agreement.

"Taxable Canadian property" is defined in paragraph 115(1)(b) ITA to include such assets as real property situated in Canada, capital property used by a non-resident in carrying on business in Canada, shares in the capital stock of a corporation resident in Canada (other than a public corporation) and shares in a public corporation if at any time during the five years preceding the disposition, and after 1971, the non-resident and/or persons with whom the non-resident did not deal at arm's length owned not less than 25% of the issued shares of any class of the capital stock of the corporation. Non-residents who dispose of "taxable Canadian property" other than certain excluded property such as shares in a public corporation are subject to special reporting requirements under Section 116 ITA.

COMMENTS

At present, the Act appears to favour individual savings through registered retirement savings plans and registered home ownership savings plans, since payments into such plans are deductible from income within certain limits (basically the lesser of $4,000 - rising to $5,500 pursuant to the recent Budget - and 20% of earned income per year for the former, and $1,000 per year for the latter). Arguably, these measures tend to attract personal savings away from investment in Canadian equities. Were it thought desirable to favour private investment in Canadian equities, certain changes to the rules regarding the taxation of capital gains might be envisaged.

A specific problem which can affect the owner of a family business is the deemed realization of accrued capital gains upon death, with the one possibility of deferral where the business is left to the taxpayer's spouse. As January 1, 1972 recedes into the past and capital gains accrue, this rule may result in the break-up or premature sale of many family businesses.

Another specific problem affecting small incorporated businesses is the treatment of a shareholder's loss on loans made or guaranteed by him to his corporation. This loss is treated as a capital loss, with the resulting limitations as to its deductibility that are noted above.

A further, perhaps minor, problem is that of the taxpayer holding a worthless investment, such as delisted stock, which he may not be able to dispose of. Failing a disposition of the investment, his loss may not be realized for tax purposes.

A number of approaches which might alleviate the rigour of the present system for taxing capital gains may be considered.

a) An annual deduction somewhat akin to the present $1,000.00 deduction for dividends and interest could be implemented. Individuals could be allowed to realize up to a certain limit, such as $5,000.00 taxable capital gains in each year, without being subject to tax thereon. If it was thought desirable, this deduction could be extended to investments in Canadian equities only.

b) *Allowable capital losses, including losses on loans and guarantees, could be made fully deductible from income from all sources, upon realization.*

c) *Taxpayers holding worthless investments could be permitted to deduct one-half of their loss from ordinary income under rules akin to those presently governing bad debts. The deduction would only be available in the year in which the taxpayer could demonstrate that his investment had become substantially worthless and the adjusted cost of the investment would be reduced accordingly.*

d) *Taxation of the gain deemed to arise upon the death of the owner of a private business could be deferred in much the same way as it presently is for a family farm under subsection 70(9) ITA. For example, where the deceased taxpayer's interest in the business (including shares in a company owning the business) passed to his children, or to other close relatives, that interest would be deemed to have been disposed of by him for proceeds equal to its adjusted cost base, and to have been acquired by his children at an equal cost.*

Employees' Stock Ownership Plans. The Act makes provision for a number of statutory deferred compensation plans which may provide a means whereby an employer can make provision for its employees. The plans which are given statutory recognition are the registered pension plan, the registered retirement savings plan, the deferred profit-sharing plan and the registered supplementary unemployment benefit plan. Normally these plans have as their common characteristics:

a) contributions to the plans are deductible within certain prescribed limitations by the employer or the employee;

b) the trusts which administer the plans are exempt from tax;

c) beneficiaries under the plans are not taxed until distribution when all benefits received out of the plan are taxable;

d) the investment of funds by the trustees of such plans is generally subject to restrictions.

The rules regarding employees' stock option plans, found in Section 7 ITA, may be summarized as follows:

a) no deduction is available to the company granting the option;

b) no benefit is taxable to the employee upon the granting of the option or, if transferable, upon such option becoming vested in a person (a preferred transferee) by one or more transactions between persons not dealing at arm's length with each other;

c) upon the exercise of the option, or upon its arm's length transfer, by either the employee or a preferred transferee, the employee is deemed to receive income equal to the excess of the fair market value of the shares on that date over the amount paid or to be paid for the shares;

d) if the option is exercised by the employee himself, the amount of the taxable benefit is added to the cost base of the shares: paragraph 53(1)(j) ITA.

Certain employers have a phantom stock plan', whereby certificates of 'phantom stock' are issued to employees entitling them to benefits upon retirement, or at some other future date. The amount of the benefit may be determined in a number of ways; one variant is to tie it to the value of the employer's shares (which may or may not be listed) at the time the employee's entitlement to the benefit arises. A benefit under a phantom stock plan is generally deductible by the employer, and taxable to the employee, at the time it is actually paid.

COMMENTS

Each of the above arrangements has its advantages and its inconveniences. In particular, a phantom stock plan affords a deduction to the employer, while a stock option plan does not. On the other hand, only the latter can eventually result in employees becoming shareholders in the company. Employee shareholding could be encouraged by permitting an employer to deduct the cost of shares issued by it to its employees. The benefit of this rule could be limited to cases where the employer corporation was resident in Canada and was dealing at arm's length with the employee. The amount by which the paid-up capital of the corporation was increased upon the issue of such shares to an employee could be allowed as a deduction to the corporation, at that time, up to a maximum per employee in each year. The employee, rather than being taxed on the value of the benefit received, could be deemed to acquire the shares at a nil cost and if the shares were held for a certain period of time, such as five years, the proceeds of disposition could be taxed as a capital gain. If the shares were held for a lesser period of time, the proceeds of disposition could be taxed as ordinary income in the employee's hands.

Venture Capital Corporations. A further incentive for Canadian investment in small or medium-sized businesses could be achieved by the adoption of measures similar to those which are presently being introduced by the Provinces of Quebec and Ontario, and which upon present information would appear to be as follows.

In order to qualify as a SODEQ (Société de développement de l'enterprise québécoise), a corporation must be registered with the Minister of Industry and Commerce of Quebec, its issued capital must be not less than $1,000,000 and it must invest in qualifying small and medium-sized manufacturing firms by way of loan (for a minimum term of five years) or of subscription for shares. A qualifying firm must be a manufacturing firm whose production is mainly carried on in Quebec, and whose voting shares are held, in the majority, by persons residing in Quebec. A corporate or individual

taxpayer subscribing for shares of a SODEQ (but not purchasing issued shares from others) may deduct from his Quebec tax otherwise payable twenty-five per cent of his cost, not exceeding $25 per share. A SODEQ would appear to be taxable by Quebec in the normal manner.

The Ontario proposal is somewhat different. The original shareholder of a VIC (Venture Investment Corporation) is allowed to deduct 250% of his investment from his income subject to Ontario tax, and the VIC itself is exempt from Ontario tax.

In his Budget Speech of May 25, 1976, the Minister of Finance of Canada indicated that he was willing to explore comparable avenues, and invited public comment.

COMMENTS

Any measure which might be adopted to stimulate venture capital investment might seek to achieve the following goals:

a) In order to attract funds and to recognize inherent risks, a deduction of the cost of his shares could be granted to the individual investor in a venture capital corporation. In order to encourage a certain marketability of those shares, this deduction could be available regardless of whether the shares were newly subscribed-for or purchased from a selling shareholder.

b) Growth of the venture capital corporation could be encouraged in particular by an exemption from tax on any capital gains realized by it.

c) The proceeds of sale of shares in such a corporation could be included in a taxpayer's income in full, although if he had held the shares for over a certain period of time, such as five years, his proceeds of sale could be taxed as a capital gain.

d) Loans to such corporations could be encouraged by providing that any losses on such loans would be deductible in full by the creditor.

CONCLUSION

In summary, the Act does not appear to contain any fundamental bias which is either in favour of or detrimental to corporate concentration. However, there are a number of aspects of the income tax system which undoubtedly influence the differing tax burdens borne by corporations, large and small, and by their shareholders. These we have attempted to summarize in a general way.

In indicating some possible changes in these and other areas depending upon the policy objectives sought to be achieved, we have attempted to confine ourselves to changes which would not result in yet another major revision of the Act at this time.